

## **Malaysia Competition Commission**

### **Guidelines on Market Definition**

These Guidelines are not a substitute for the Act or any Regulations made under thereto. These Guidelines may be revised should the need arises. The examples given in these Guidelines are for illustrative purposes only. They are not exhaustive, and do not set a limit on the investigation and enforcement activities of the MyCC. In applying these Guidelines, the facts and circumstances of each case will be considered. Persons in doubt about how they and their commercial activities may be affected by the Act may wish to seek legal advice.

The MyCC would advise enterprises to conduct a self-assessment exercise of their businesses in respect of their conduct, procedures, management and control. They should also have competition compliance procedures in place for all their employees at all levels, including Board of Directors.

#### **1. INTRODUCTION**

- 1.1. These guidelines show how the Malaysian Competition Commission (“MyCC”) will define markets when investigating possible infringements of Chapters 1 and 2 of the Competition Act 2010 (“Competition Act”).
- 1.2. The term ‘market’ has a special meaning in competition law which may differ from how enterprises define a market for their own business purposes. The reason for this is that defining a market for competition law purposes is ultimately about determining the level of competition and so issues of market power. The goal is to include within the defined market all those firms that can effectively compete with the product that is being complained about – which includes firms that can enter a market within a reasonable time. A market for competition law purposes is called a ‘relevant market’.
- 1.3. The term ‘market’ is defined in Section 2 of the Competition Act as:

‘a market in Malaysia or in any part of Malaysia, and when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services’.
- 1.4. Defining a ‘relevant market’ means identifying all the close substitutes for the product under investigation. Products can be substituted both on the demand and on the supply side. For example, suppose there is a complaint about an anti-competitive agreement between apple producers. The question for competition law is whether the ‘relevant market’ is the ‘market for apples’ or a broader market that includes substitutes for apples. The essential issue is whether, if the price of apples goes up:

- will consumers (i.e. on the demand side) switch to other fruits? or
- will producers of other fruits (i.e. on the supply side) quickly switch to produce apples?

If consumers will not switch to other fruits or producers will not switch to apples then the relevant market is a market for apples. On the other hand, if consumers switch to other fruits or other producers switch to producing apples, then this means the other fruits and producers compete with apple producers. The relevant market should include these competing fruits and those producers. This will be explained in more detail below.

1.5. Defining a 'relevant market' allows the MyCC to:

- identify all the enterprises who compete against the enterprise against whom the complaint has been made (i.e. who compete **in the same market**).
- determine whether an agreement violates the Chapter 1 prohibition because it has the “effect of significantly preventing, restricting or distorting competition **in any market** for goods or services”. Market definition is important to determine whether there is a **significant anti-competitive effect in a market**.
- determine whether conduct by a dominant enterprise violates the Chapter 2 prohibition by engaging in conduct which “amounts to an abuse of a dominant position in any market for goods and services”. To be dominant in a market requires assessing whether a firm has substantial market power **in a market**.
- take into account the turnover of the firm in the relevant **market** in assessing the size of penalty.

1.6. To define a relevant market for competition law purposes, the MyCC will use the ‘Hypothetical Monopolist Test’ (“HMT”)<sup>1</sup>. This test is commonly used in other jurisdictions with competition law and is described in detail below. It should be remembered that market definition is a crucial first step in a competition analysis. Once the market has been defined, the next step involves conducting an analysis of the competition within that market. The second step involves:

- Determining the market shares of competitors;
- Assessing how easy it is to enter the defined market by examining whether there are any barriers to entry into the market; and
- Evaluating the way competition is conducted e.g. among others whether competition is mainly on the basis of price or on the basis of product features.

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<sup>1</sup> This test originally derives from the United States where it is called the ‘SSNIP’ test’ i.e. a ‘Small but Significant and Non-Transitory Increase in Price’ test. They are equivalent.

1.7. While the definition of a market is important in determining anti-competitive effect and determining whether a firm is dominant, it is also useful from an enforcement perspective because it allows the MyCC to identify relatively quickly situations where agreements do not have a significant effect on competition or where enterprises clearly do not possess market power. For example, if a potentially anti-competitive horizontal or vertical agreement involves competitors with a small market share then the MyCC will normally close a Chapter 1 investigation at an early stage because the anti-competitive effect of the agreement is unlikely to be significant - unless other relevant factors provide strong evidence of collective market power.

1.8. However, it should be noted that for certain kinds of horizontal agreements the MyCC does not have to determine the anti-competitive effect. Certain horizontal agreements are **deemed by the Act** in section 4 (2) to be anti-competitive. These include:

- price-fixing;
- sharing markets or sources of supply;
- limiting or controlling production, market outlets or access, technical or technological development or investment; or
- bid-rigging

1.9. Where it seems unlikely that conduct will either have a significant adverse effect on competition or that the enterprise does not possess substantial market power, the MyCC may not need to precisely define the market. It should be stressed that defining a relevant market requires considerable practical judgement. In some cases it may not be even necessary to define the relevant market precisely. For example, where there is evidence that the relevant market is one of a few possible market definitions and each of these market definitions lead to the same competition assessment then precise market definition is not necessary and would be a waste of resources.

1.10. These guidelines do not substitute for the Competition Act or for any regulations made under the Competition Act. They are to provide guidance to enterprises on how the Competition Act will be interpreted by the MyCC and may be changed from time to time as the need arises. The examples given in these Guidelines are for illustrative purposes only and are not meant to be exhaustive nor limit the MyCC's investigative and enforcement activities. If there is doubt about the Competition Act then legal advice should be sought.

## 2. MARKET DEFINITION

### *The Hypothetical Monopolist Test*

- 2.1. For most people a “market” usually means a particular geographical area where buyers meet sellers to buy a product. However, for competition law purposes the word ‘market’ has a more precise meaning. To avoid potential competition law problems enterprises should identify the markets in which they operate for competition law purposes using the approach provided in these Guidelines.
- 2.2. In identifying the relevant market for competition law purposes the MyCC will use the HMT. This is a conceptual approach used to define relevant markets. The HMT defines the relevant market as:
- “the smallest group of products (in a geographical area) that a hypothetical monopolist controlling that product group (in that area) could profitably sustain a price above the ‘competitive’ price i.e. a price that is at least a small but significant amount above the competitive price.”
- 2.3. The MyCC will use a price-range of 5-10% to represent **a small but significant increase in price** (“SSNIP”). However, it should be recognized that the HMT only provides an analytical framework for assessing whether products are likely to be “substitutable for, or otherwise competitive” with the relevant product. The HMT is rarely able to provide a precise answer. Once identified, that product group (and area) is the relevant market for competition law purposes because all the competitors to the enterprise(s) about whom a complaint has been made have been identified.
- 2.4. So the goal of market definition is to find the smallest market in which a hypothetical monopolist could impose a SSNIP (of 5-10% above the competitive price). Applying the HMT involves the following steps.

### **Steps in Market Definition**

- **Step 1:** We start with a hypothetical monopolist of the **focal product** (i.e. the product that is under investigation). We then ask:
- **Step 2:** Would a hypothetical monopolist of a market for the focal product find it profitable to sustain a price for the focal product of 5-10% above the competitive level?
  - If the answer is YES – then this market definition is the relevant product market for competition purposes because all the products that compete with the focal product around that price (i.e. could be substituted for the focal product at that price) have been identified. The market definition is completed.

- If the answer is NO - then this means that other products compete with the focal product. So, the products that next compete with the focal product (the closest substitutes) should be included in the definition of the relevant market. The next step involves asking the same question with a broader product.
- **Step 3:** The question is repeated. Would a hypothetical monopolist of a market for a combined market for the focal product plus the close substitutes identified in Step 2, find it profitable to sustain the price of the focal product 5-10% above the competitive level? If yes then the relevant market is the market for the focal product plus the close substitutes. If no, then we add the next closest substitutes and repeat the question until the point is reached where a hypothetical monopolist could sustainably maintain price 5-10% above the competitive price.

2.5. In practice, market definition involves determining two dimensions, a product market and a geographic market. While sometimes these two aspects can be considered together, usually the product market will be defined first and the geographic market second.

### **Economic Evidence That Is Useful to Indicate the Relevant Market**

2.6. Evidence concerning market definition may come from a variety of sources including:

- market research surveys that deal with consumers' willingness to switch products as price changes;
- interviews with industry associations ;
- interviews with the initial complainant. Often this will be a competitor. If so, the complainant would be asked to provide relevant information including their own marketing documents;
- interviews with competitors. Evidence from other enterprises selling similar products and their commercial strategies may also be useful and a good source of information about competition dynamics. Enterprises often identify their competitors and the products they compete with in marketing reports. Apart from marketing reports, other company documents such as internal communications, public statements, and studies on buyer preferences or business plans could also provide useful evidence;
- interviews with customers - while this is feasible for markets with limited numbers of buyers this may not be possible where there are large numbers of consumers given the cost of conducting surveys. Furthermore, survey responses to a question about a hypothetical price increase may not really represent decisions that would be actually made in response to a real price increase;
- evidence on switching costs (either real or perceived) that buyers face in switching to another product could be important. Buyers could be deterred

from substituting another product because of the high costs involved. For example, changing from one computer operating system to another can involve time-consuming learning of the new product. If switching costs are high relative to the product price then less substitution is likely;

- similar price changes over time may mean products are in the same market because they are subject to the same competitive pressures. But similar changes in price might also reflect changes in the price of a common input and not competition. For example, the price of products using substantial amounts of electricity will rise and fall as the price of electricity changes. Data on similar prices needs to be treated with caution;
- the availability and/or the usefulness of information may depend on the kind of product being investigated. For example, in some cases, products may compete more on the basis of product features than on price. The MyCC will adapt its approach to market definition to take into account the peculiarities of any particular market under investigation;
- own or cross price elasticity: The own price elasticity of demand provides estimates of the percentage change in demand for a product (for example, the focal product) arising from a change in its price. The cross price elasticity of demand measures the percentage change in demand for a product (for example, a rival product) in response to a change in price of another product (for example, the focal product). In general, if there is little change in the amount of a product bought by buyers as a result of a change in price (either in the price of the product itself or the rival product) then this could imply that there is limited substitutability.

2.7. Another dimension that may be relevant in defining markets is time – either over a day or over a longer period. The relevant product may be defined as the supply of the particular product at a certain time of the day or a certain time of the year. Two examples where time is important include:

#### Peak and Off-peak Services

- Over a day: example peak and off-peak bus services
- Seasonal: example holiday packages during peak season (school vacations) and other times

The answer depends on whether there is demand and supply substitution between the periods. If peak consumers cannot switch to off peak and suppliers cannot switch capacity between the two periods then they are likely to be in separate markets.

#### Innovation/ Inter-Generational Products

- For example: hand phones and computer tablets. Consumers may choose to defer expenditure on present products because they believe innovation will soon produce better substitutes or they may own an earlier version of the

product, which they consider to be a close substitute for the current generation.

2.8. As described above, defining the product market means finding the smallest product market in which a hypothetical monopolist could impose a SSNIP (of 5-10%). This is illustrated in Box 1.

#### **Box 1 Determining the Relevant Product Market - Example**

The MyCC receives a complaint that a green apple producer GREENAPP is fixing the retail price of green apples. So the MyCC needs to consider whether the conduct has a significant anti-competitive impact in the market. How would the relevant market be determined? The MyCC starts with the focal product 'green apples' and asks whether a *hypothetical monopolist* of green apples would be able to profitably increase the price of green apples by 5-10% above the competitive price. If the answer is yes then the relevant product market is green apples. If the answer is no – then the next available substitute product – say red apples – is added to the proposed relevant market definition. The question is then asked: would a hypothetical monopolist of green + red apples be able to profitably raise the price of green apples by 5-10% above the competitive price? If yes then the relevant market is the market for green + red apples because there are no other products that consumers would substitute for green and red – all the competitive products have been identified. If the answer is no then this means there are other products apart from green and red apples that consumers would switch to if the price of green apples was increased – and so those products should be included in the relevant product market. The process continues until all the products that reasonable compete with green apples are identified.

2.9. Products do not have to be identical or have the same physical characteristics to be substitutable by consumers. In the above example red apples compete with green. Another example is if the price of take-away food is increased, a significant number of consumers might switch to eating in a restaurant. If so, then those selling take-away food will need to take into account the prices charged in restaurants. What matters in defining the relevant market is whether consumers themselves see the products as substitutes as the price of the focal product changes. Further, if two products serve the same function (e.g. toothbrushes) but one product is a premium product which has a much higher price and quality than the other, both products (toothbrushes) might be included in the same market if, say, an increase in the price of the premium product (toothbrush) led buyers to switch to the lower priced, lower quality product (toothbrush).

2.10. An important issue is whether the hypothetical monopolist could sustain the SSNIP price. The more quickly buyers can switch products, the greater the constraint on the exercise of seller market power. This will depend on the kind of market. As a general guide the MyCC will only include products in the relevant market that consumers could switch to within 12 months. Any longer would mean the product

does not provide an effective, immediate constraint on the hypothetical monopolist's ability to price as it likes. However, the time period used to assess buyer switching may be significantly shorter than one year, for example, in markets where purchases are made frequently. Each case will be examined on its merits.

## **The Relevance of the Supply-Side to Market Definition**

2.11. Enterprises might be prevented from charging higher prices if other enterprises currently not supplying the product in question could easily switch production or otherwise supply the focal product and its substitutes within a short time period. In other words, substitution can occur from the supply side as well.

2.12. Supply-side substitution can be thought of as a special case of entry into a market that:

- occurs quickly (generally less than one year);
- is effective (generally on a scale large enough to affect prices); and
- does not involve substantial sunk investments (i.e. investment costs that cannot be recovered if the investment fails – e.g. advertising expenditures on a new product).

2.13. For example, different kinds of soft drinks can be produced using the same production facilities. Suppose one soft-drink manufacturer produces a premium drink but the other producers currently do not. Suppose the premium soft drink manufacturer raises the price of the premium brand by 10%.

2.13.1.1 Consumers may be reluctant to switch to (substitute) other brands because of its 'image'.

2.13.1.2 However, even if consumers do not switch, other soft-drink producers may be able to easily switch to producing the higher quality soft-drink by simple changes to their production processes.

2.13.1.3 If so, then the relevant market includes not only the premium soft-drink but also the lower quality soft-drinks because this immediate supply side substitution places a constraint on the ability of the premium soft-drink manufacturer to profitably raise price.

2.14. Enterprises that can potentially supply the product in less than 12 months would normally be included in the definition of the relevant market.

2.15. Evidence of supply-side substitution could be determined by:

2.15.1.1 Asking potential sellers whether substitution is technically feasible taking switching costs and the likely time to switch production and whether it would be profitable.



- 2.15.1.2 Assessing the level of existing capacity. For example, enterprises may already be operating at full capacity and would not switch. The availability of necessary inputs and distribution channels are also important to the switching decision.
  - 2.15.1.3 Obtaining the views of buyers about how loyal they are to existing products and whether they would consider buying from new sellers.
- 2.16. The MyCC will only take supply side substitutability into account in market definition when entry is reasonably likely to occur and is a factor that existing producers take into account in making their decisions. If supply-side substitution cannot take place quickly and easily, then the market will be defined only on the basis of demand-side substitutability. Longer-term potential entry will then be considered when assessing the longer term barriers to entry as part of the competition analysis.

### **3. THE GEOGRAPHIC MARKET**

- 3.1. As mentioned previously the term 'market' is defined in Section 2 of the Competition Act as "a market in Malaysia or in any part of Malaysia". This means that other countries are not included as part of the definition of the relevant geographic market. For example, even if imports could easily come into Malaysia from Thailand for a particular product, the geographic market would not be defined to include both Malaysia and Thailand. Instead, the relevant geographic market would be defined as Malaysia and imports from Thailand would be considered in the next stage as part of the competition analysis.
- 3.2. Similar to the definition of the product market, for competition law purposes the geographic market refers to the area over which consumers can substitute the products under consideration and the area over which sellers can competitively sell the relevant products. If consumers can travel from Gombak to Petaling Jaya to have their hair cut when the price in Gombak is increased, then the geographical spread of a relevant hairdressing market is wider than just Gombak. If, on the other hand, hairdressers from Penang would travel to Kuala Lumpur because the price in Kuala Lumpur has risen, then the geographic market should also include Penang.
- 3.3. The geographic scope of the market is defined using the same framework used to analyse the product market. Defining the geographic market starts by identifying a relatively narrow geographic area, called the focal area. This is the narrowest area in which the group of products identified in the product market definition compete – for example a town or suburb. Then the question is asked: could a hypothetical monopolist of the group of products identified in the relevant product market, operating in that focal area, profitably increase the price by 5-10% above the competitive price? If the answer is:

- 3.3.1. Yes – then this is the geographic market because consumers will not buy elsewhere and producers outside the region will not supply the focal area.
- 3.3.2. No – this means buyers will go to neighbouring areas to buy or sellers from neighbouring areas will now come into the focal area to sell in response to the higher price. This means these neighbouring areas should be included in the geographic market definition.
- 3.4. This process continues until a hypothetical monopolist of the group of products identified in the product market definition could profitably raise price by SSNIP (i.e. 5-10%) in that area.
- 3.5. The evidence used to define a geographic market on the demand side is usually similar to that used to define the product market. An additional consideration is the value of the product in relation to transport costs. Generally, the higher the price of a product relative to the costs of travelling, the greater the willingness of buyers to travel further to buy cheaper supplies. If buyers and sellers face high transportation costs, then the geographic market will be smaller than when transport costs are low. The higher the costs of transportation, the smaller the geographic market is likely to be. In the case of services, geographic markets may be quite narrow because services like personal services (hairdressing, accounting etc) cannot be easily transported.
- 3.6. Box 2 examines the steps required to identify the relevant geographic market. In practice both product and geographic markets may be determined at the same time.

#### **Box 2 Determining the Relevant Geographic Market - Example**

Following on from the example in Box 1, the geographic market needs to be determined. Here the MyCC would start with the smallest geographic market i.e. the geographic market of the biggest retail store and ask would a hypothetical monopolist of green and red apples in this retail store be able to profitably increase price by 5-10%? If the answer is yes then the relevant geographic market is the retail store. Consumers would not travel elsewhere outside the retail store and other suppliers of green and red apples would not supply to the retail store. If no, then a wider geographic area contains competitors who constrain the hypothetical monopolist's ability to profitably increase price by 5-10% above the competitive price. The next biggest geographic area is likely to be the suburb in which the retail store is located. So the geographic area is expanded and the question becomes – if there was a hypothetical monopolist of red + green apples in that suburb would the hypothetical monopolist be able to increase the price of apples by 5-10% without losing sales? If it was profitable then the relevant geographic market would be the market for red + green apples in that suburb. If the answer is no that means that consumers would buy outside the suburb or suppliers outside the suburb would supply into the suburb. So the geographic area is expanded until the price increase can be profitably sustained.

## 4. Some Other Important Issues

### ***Identifying the Competitive Price***

- 4.1. The hypothetical monopolist test uses the competitive price as the base price. However, determining the competitive price is difficult in practice. In highly competitive markets the competitive price is close to cost. However, in many markets the competitive price may lie somewhere between cost and a monopoly price. So, by using the prevailing price, the HMT test is only determining substitutability at current prices.
- 4.2. Incorrectly identifying substitutes at a price above the competitive level is known in the United States as the 'cellophane fallacy'. A monopolist will be, already, charging a monopoly price. A monopolist who increases price by 5-10% above this price will lose sales and so have reduced profits because there are substitutes at the higher price. However, there may be no substitutes if the monopolist charges a much lower price e.g. a price close to cost. If a market is defined to include the substitutes at this high price then the market will be defined more widely than it would be defined at the lower competitive price. It is only the fact that the price is so high that there are substitutes.
- 4.3. The Cellophane Fallacy is explained in more detail in Box 3.

#### **Box 3 – the Cellophane Fallacy**

In a 1956 Supreme Court Case in the United States – *US v. El du Pont de Nemours & Co* 351 US 377 (1956) Du Pont had 75% of US sales of cellophane – the other 25% was produced under licence from Du Pont. Cellophane accounted for about 20% of the sales of all flexible packaging materials (paper, film, foils etc). The Supreme Court's decision depended on the market definition. The Supreme Court found there was sufficient evidence of substitution between cellophane and the other packaging materials e.g. meat producers regularly switched between different types at the current price – and that Du Pont would be preventing from increasing the price of cellophane further. Cellophane was 2-3 times more expensive than its nearest competitor (grease proof paper and glassine). But the Court found that if the price of cellophane was *further* increased that the other packing materials would be substituted sufficiently to stop Du Pont from doing so. The fallacy in the Court's reasoning was that cellophane was already priced at a monopoly price level (i.e. Du Pont was already taking advantage of its market power). But, because Du Pont, was already profit-maximising it would not raise the price of cellophane further. So the Court was assessing the substitutability at the monopoly price where there was likely to be consumer substitution rather than the competitive price – where there would be little substitution (hence pointing to a separate relevant market for cellophane only).

- 4.4. However, understanding the degree of substitution even at prevailing prices provides useful information about substitution and competitive constraints. Evidence that prices are above competitive levels might include excess profits or

past price movements. The MyCC will take into account the possibility that current prices do not reflect competitive prices when all the evidence on market definition is considered.

## **Competition Law Cases Decided Previously in Malaysia or Elsewhere**

4.5. Although there might be cases where a market would have been investigated and defined in an earlier investigation, competition conditions do change over time and should be taken into account. This is especially so in the case where there is innovation, which could make substitution between products easier or harder. Therefore, changing circumstances may require a new market definition at different times because competitive constraints have changed. Market definitions used in other countries similarly may provide a useful starting point to identify important issues in particular markets but will not be determinative in defining relevant markets in Malaysia because the factual basis for determining competition in Malaysia may be different.

## **5. Market Definition Where there is Product Differentiation**

5.1. The HMT works best when products are homogeneous. However, many markets contain differentiated products, for example products that are differentiated by features such as brand, location or quality. Here, it may not be possible to identify clear boundaries in defining the market, even within the same area at the same time. For the purposes of the HMT sometimes product differences may be ignored for the analysis. For example, expensive sports cars may be considered together with luxury cars even though they are not exactly the same.

5.2. However, there are markets where the degree of product differentiation may be so great that the HMT is misleading. In that case the MyCC may decide not to define a market precisely and simply focus on the constraints to the exercise of market power directly.

5.3. Market definition is essentially about whether a product is 'in the market' or out of it. For example, do Malaysian shoes compete in the same market as Indonesian shoes or not? If Indonesian shoes are in the same market, then they serve as a competitive constraint to producers of Malaysian shoes. Market definition is an intermediate step to get to the final analysis of competition. Products and areas in the market compete. Those outside the market do not.

5.4. Where products are highly differentiated, it may be more productive to assess the extent to which the differentiated products are substitutable directly, rather than working through the HMT. So the question would be whether Indonesian shoes directly affect the decisions of consumers when considering Malaysian shoes. Inevitably, pragmatic judgement is required.

5.5. In other cases, sellers may bundle distinct products. For example, furniture sellers might bundle different items of furniture for sale for the bedroom or dining room. Or telecommunications companies might bundle local calls with an internet subscription. Buyers' views would be important in assessing the appropriate

frame of reference i.e. whether consumers see the bundle as a group of products that they prefer to buy together or not.

5.6. While, normally competitors are identified in the same market, sometimes competition up or downstream may also constrain competition. For example, suppose a wholesaler sells product A to a retailer which the retailer in turn uses to sell product B. Suppose another vertically integrated wholesaler sells product C which is a substitute for product B at the retail level. The ability of buyers to substitute product C for product B at the retail level may constrain the first wholesaler's ability to raise the price of product A.